

THREE YEAR COMPETITION REVIEW OF THE ELECTRICITY
MARKET OF KOSOVO
(Draft)

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INTRODUCTION

The Athens Treaty requires the creation of a competitive market for electricity, where all consumers should enjoy continuous supply of electricity and a chance to choose their supplier.

To enable development of operations in the energy sector and based on the requirements of the Energy Community Treaty (ECT), primary laws for the energy sector such as Law on Energy, Law on Electricity and Law on Energy Regulator were passed in Kosovo. With the Assembly of Kosovo adopting the Law on Energy Regulator, the establishment of the Energy Regulatory Office was made possible, with a mandate for economic regulation of the energy sector in Kosovo.

An important institution for promoting competition in Kosovo is the Kosovo Competition Authority established by the Assembly of Kosovo, based on the Law on Competition. The Kosovo Competition Authority is an independent body and has the responsibility and authority to promote competition among enterprises and to protect consumers in Kosovo.

The Energy Regulatory Office in consultation with the Kosovo Competition Commission and the authority responsible for monitoring state assistance will conduct investigations at least every three (3) years related to the functioning of the electricity market, as well as decide and impose all necessary and proportional measures intended for stimulating effective competition and ensuring a properly functioning market. These measures can include programs for releasing electricity according to which electricity enterprises are obliged to sell or make available a certain amount of electricity or to give access to interested suppliers in a share of their production capacities for a certain time period.

It should be emphasized that the three year review is not connected to the investigation of potential abuses of the dominating position according to the competition law. It is an evaluation to present measures that need to be taken to promote effective competition, in particular if a need exists to request for electricity generating capacities to be allowed for other suppliers in order to enable them to compete effectively.

This evaluation report represents the assessment of the ERO whether or not an effective competition in supplying privileged consumers exists. This is the second evaluation by the ERO on effective competition in the electricity market, whereas the first evaluation was made three years ago.

1 Technical Aspects of the Electricity Market in Kosovo

Generation, transmission and distribution are fundamental components of electric energy systems, which are integral parts of an energy market.

Lignite represents the main reserve as a primary source of energy in the Republic of Kosovo with about 97% participation in the overall electricity generation.

The Southwest Sibovc Mine and Bardhi & Mirashi Mines supply the power plants Kosovo A and Kosovo B with lignite.

Generating capacities of electricity consist of two thermal power plants, TPP Kosovo A and TPP Kosovo B, and HPP Ujmani with other distributive HPPs which makes about 3% of the overall capacity.

The Transmission System plays an important role in security of supply and progress of the entire power system. The transmission network of Kosovo is an important node and it is interconnected to the regional and European power system. Interconnection lines of 400kV exist with neighboring countries, apart from Albania with which only a 220kV line exists. The construction of the 400kV interconnection line SS Kosovo B – SS Kashar (Tirana) is expected to begin very soon. The transmission network is generally stable and sustainable. The losses in the Transmission Network have been visibly reduced during the last years thanks to investments, more accurate measurements and better management.

The Distribution Network has shown improvement in consumer supply and service quality over the past years. However, even with all the investments made in the past years, the distribution network is incapable of securing proper supply and satisfactory quality for consumers. To achieve an acceptable level of supply and service quality, additional investments are needed, both in medium as well as low voltage levels.

2 Regulation of the Electricity Sector – Importance of Competition in the electricity market in Kosovo

The concept of removing exclusive rights from public vertically-integrated monopolies and allowing competition in the energy sector has started to captivate the minds of EU and US policymakers since the year 1980. For many years, the electricity sector in most industrialized countries was characterized with an expansion of electrification with a higher demand, which has justified a monopolistic structure, where average regulated prices were kept above side costs, and based on the economy of scale and opportunity it achieved a continuous price decline. That happy state of trade lasted until the years 1970 and 1980, when the direct and indirect effects of the oil crises destabilized the entire structure.

It had become clear that in order to achieve higher efficiency and to improve service quality, it was necessary to introduce competition into the electricity sector. This concept was accelerated during the '90s, because competition was the basis for the creation of a European common market. Competition encourages companies to evaluate every service that is produced with more efficiency.

The successful introduction of competition will lead to a more efficient industry. The generators will better utilize their plants in order to maintain or expand the number of clients they can cover. The effective regulation of services from separate networks (ex. Transmission and distribution) will also encourage the decrease in prices. Suppliers will interact with more efficiency with clients and will offer a wider range of services and contractual agreements. For this reason, in long term, a high enough scale of competition will ensure that the prices are on average lower than they would be in a regulated market.

The unique characteristics of the energy sector, mainly the necessity of continued security of supply, environment protection, the common concept of “transporters” of networks energy and public service obligations, have necessitated a specific regulatory framework in which competition and private enterprises can operate. This framework was finalized by the Directives and Regulations of the European Commission on Electricity and Gas (which are in force now).

After many years of experience with opening the energy sector to competition, many countries have presented a more or less similar regulatory framework for a liberalized energy market, composed of:

- An independent Regulatory Authority with a mandate of minimal monitoring and promotion of market development and operations, approval of prices for operations outside the market, issuing of ordinances, regulations and measures for non-discriminatory access of third parties into energy networks;
- An independent Transmission System operator;
- Competitive Wholesale markets in production and Supply.

The EU directives call for close monitoring of the market and the ability to present a number of main obligations to energy companies (“public service obligations”) related to public service. These obligations can include “universal services” (the right of all consumers to be connected and supplied), protection of vulnerable customers, protection of final consumers (transparency of contractual terms and guaranteed access to oppose agreements), etc. These precautions are especially important during the transition period from a fully regulated monopoly to a situation where the market decides important features such as price and investment decisions. The role of the independent Regulatory Authority is very important in translating public service obligations, set by the Government in Market policies and in approval of the satisfactory level of compensation for its implementation.

It should be emphasized that in countries where there is not enough competition in the area of production and supply, regulation is often applied on all market elements (production, transmission, distribution and supply), as is the case of Kosovo, but other countries as well. The separation begins with the transmission part, then continues with the unbundling of the distribution system and by encouraging the opening of the energy market for all consumers.

3 Competition indicators in the Energy market in Kosovo

Electricity markets are generally sensitive, and it is important that measures be taken so that the market structure enables competition. Competition indicators are presented in the table below, through which the scale of competition in the electricity market in Kosovo can be understood.

Main Performance Indicators – Market structure		
Indicator	Measure/Scale	Comment
Reciprocal price relation between price zones	Reciprocal price relation between prices of wholesale market	Relies on price availability
Price differences	Price between market zones	Relies on price availability
Market concentration, Generation	HHI* C3*** Number of companies with more than 5% of the market	MW, GWh
Market concentration, Retail market	HHI* C3*** Number of companies with more than 5% of the market	GWh
Vertical unbundling of generation by the TSO	Functional and Calculate: YES=100%, NO=0% Legal: YES=100%, NO=0% Ownership: YES=100%, NO=0%	Measurement should be based on legal requirements being implemented
Vertical unbundling of supply/retail market by the DSO	Functional and Calculate: YES=100%, NO=0% Legal: YES=100%, NO=0% Ownership: YES=100%, NO=0%	Measurement should be based on legal requirements being implemented

*Herfindahl-Hirschman Index

** Concentration of the three largest companies

From the above indicators, it can be noted that different prices are required, whereas in Kosovo we have regulated prices. Furthermore, the scale of competition in Kosovo is low, where a single state generator (TPP Kosovo A, B) dominates about 90% of the internal market, and these generators are legally obliged to supply the local regulated customers first. This limits competition possibilities and reduces or eliminates the incentive for privileged consumers to exercise eligibility.

A big problem is the lack of unbundling of supply and distribution, thereby limiting the entry of new suppliers into the market. The fear is in that the new suppliers will not be treated equally.

4 Social aspects impeding the promotion of Competition

It is known that Kosovo suffers from a deficit of electricity. Even though the regulated tariffs can cover the cost of the existing system, those price levels are not sufficient for covering the cost of new investments on a commercial basis. An increase of prices in this way can be considered to constitute a big obstacle in the affordability of prices by consumers.

With the current regulated price, the interest of privileged consumers to exercise their right is very limited.

In certain countries, the privileged consumers are forced to be outside the open market. In order to create a well-functioning open market, it is necessary to gradually increase the number of consumers in the open market. This can be done by either eliminating the regulated tariffs option for privileged consumers, or by changing the tariff rules.

5 Current Operations of the Electricity Market in Kosovo

The Athens process has prompted new reforms and developments on all levels of the electricity sector in Kosovo, starting from the institutional, judicial and regulatory aspect, up to the operations level. The aim is clear, to set up a transparent and liquid trading model that operates on principles of free competition and signaling for both service providers as well as users.

The essential elements taken into consideration by the regulator based on ECT requirements and that ensure a competitive and liquid market are:

- Supply and demand (supply exceeding demand);
- Non-discriminatory Third Party Access (TPA) into the network and cost-reflectivity;
- Proper signaling (reaction of production and consumption to price signaling, meaning modern metering as well as modern telecommunications infrastructure);
- A sufficient number of buyers and sellers with not high concentration;
- Proper handling of subsidies;

The components outlined above have not reached appropriate maturity to guarantee liquidity and sufficient competition as a result of the lack of technical conditions. Until now all the energy was transacted through bilateral contracts between the Public Supplier and generators in Kosovo on one hand, and the traders on the other hand. The wholesale level of transaction contracts between KEDS-Public Supplier and KEK-Public Generators (Kosovo A and B) are regulated, whereas on the retail level KEDS as a Public Supplier supplies all regulated customers with regulated tariffs.

Kosovo has a lack of electricity and to overcome this deficiency, it is necessary to import energy on one hand and/or have mandatory organized and pre-determined power load shedding according to respective schemes. In the close future, the import of electricity is expected to be relatively expensive, due to the lack of electricity in the region as well as non-liquidity in the regional market, which complicates the process of establishing a national organized competitive and liquid market.

The reformation of the energy sector dates from the year 2004 as a result of the establishment of the ERO. The process of reformation has further continued with the unbundling of the vertically integrated KEK, from which KOSTT was created (year 2006), which now operates as a separate entity

of transmission and market. Further unbundling continued with KEK's distribution and supply, and subsequently their privatization by passing into ownership of the Limak-Çalik consortium. So as of 8 May 2013, the Government of Kosovo finalized the project for the privatization of distribution and public supply, managed by the Limak-Çalik consortium, whereas the other part of KEK is in public ownership and includes mining and production.

The insufficiency of current generating capacities to fulfill supply needs and the need to invest in the electricity sector in Kosovo, calls for an initiation to restructure the energy sector through market liberalization and increasing competition in the electricity market. In order to achieve these objectives, during year 2012 the KOSTT prepared the Electricity Market Design document, and in March of 2013 it was approved by the Board of the ERO. Based on the Market Design, Market Rules were developed and approved at the end of 2013.

5.1 Third Party Access into the Electricity Market in Kosovo

One of the main elements in the creation and functioning of the electricity market is the concept of Third Party Access - TPA. The principle aspect of this concept comes from the regulatory principles of the energy market and operators' legal obligations to offer transparent and non-discriminatory access to the third party in the transmitting or distribution network (system). This implies that every market participant has the right, based on set principles, to use the system, which enables the realization of electricity purchasing transactions.

From the national wholesale aspect, access from all aspects is important. The principles of using the KOSTT system for trade inside the borders of Kosovo are well defined and applicable, therefore this presents an advantage in developing the national market and subsequently helps in promoting competition and opening the wholesale market. Even technically, after installing the meters in commercial borders with parties, conditions have been created to accommodate new participants in the wholesale market.

In the aspect of cross-border trade, there are continuous obstacles and obstructions. KOSST is not treated as an equal TSO as other regional TSO's, and is not doing cross-border capacity allocation and is not part of the ITC mechanism. Being a market with a limited number of parties and, subsequently, low liquidity, this obstacle is considered the most capital in new parties' hesitation to access Kosovo's national market.

As for third party access, its relevance to the transmitting system and functions of Market Operator, we can conclude that KOSTT has prepared a good legal and technical framework for this to be executed successfully. Of course, this access refers to the wholesale market, whereas the execution of the retail market relates to fulfilling criteria in the distribution system.

Until now the Distribution does not have a methodology for using the distribution system, but the designed tariff model foresees this separation, so this should not be considered an obstacle. What could be considered an obstacle is the implementation of these tariffs, because of high levels of technical and commercial losses in distribution and in deficiency of multifunctional measurements for small consumers.

5.2 Opening the electricity market in Kosovo

The development and reformation of the market aims to create proper competition on the supplier's side, where consumers have the opportunity to get supply from different electricity suppliers.

Kosovo has opened the market where non-household customers can exercise their right to eligibility. Requirements of the Energy Community Treaty (ECT) are from 1 January 2015 all customers should be able to be qualified. In this regard can be seen below the requirements of the laws of energy in Kosovo:

- **Law on Electricity, Article 19.4** - *All customers except household customers are eligible. All customers shall be eligible customers by 1 January 2015.*
- **Law on Energy Regulator, Article 41.1.1** - *the Energy Regulatory Office may set tariffs charged to eligible customers by the electricity enterprise holding the public supply license only where the Office is not satisfied that competition in the supply of electricity is effective.*
- **Law on Energy Regulator, Article 41.1.2** - *after 1 January 2015 the Energy Regulatory Office shall discontinue setting tariffs charged to customers by the electricity enterprise holding the public supply license, unless the Office is not satisfied that competition in the supply of electricity is effective.*
- **Law on Energy Regulator, Article 41.1.3** - *any finding by the Energy Regulatory Office that competition in the supply of electricity is not effective shall be based on a comprehensive and published assessment of the market conditions. Tariff regulation shall not go beyond what is necessary to compensate for the lack of effective competition.*

In Kosovo, knowing that almost all consumers are eligible, apart from household consumers, and they are not interested in exercising eligibility as their right. The limited interest to be subjected to eligibility is explained by the fact that most consumers will face higher prices in the open market than with regulated tariffs. Considering current regulated tariffs, little interest can be expected from consumers to pass to eligible consumers.

5.3 Competition from the Supplier's standpoint

The problems which the Public Supplier faces in conditions of electricity trade and electricity sales are not favorable in circumstances where the sale or purchase of electricity is made due to the lack of generation by local generators.

For now, the Public supplier has the monopoly on electricity transaction with consumers. Another problem arises from the fact that household consumers do not pay their dues that they have to the Public Supplier.

6 Competition Evaluation Criteria

In article 41 paragraph 1.3 of the Law on Energy Regulator (2010/03-L-185 issued on 25 October 2010) it is stated:

Any finding by the Energy Regulatory Office that competition in the supply of electricity is not effective shall be based on a comprehensive and published assessment of the market conditions. Tariff regulation shall not go beyond what is necessary to compensate for the lack of effective competition.

Also, based on article 9 (1.1) of the Law on Energy Regulator, the ERO is obliged to include within its annual report a survey of developments, in particular the results of its monitoring of the development of competition and transparency in the energy markets in Kosovo. Article 15 of the same law obliges the ERO to report annually on results of monitoring of the operation of electricity markets, including monitoring levels and effectiveness of market opening and competition at wholesale and retail levels. Considering these obligations, the ERO evaluates annually whether there is effective competition in electricity supply for eligible consumers. The findings of the ERO are included in its annual report.

The Board of the ERO, in the session held on 30 March 2011, approved the criteria for evaluation of competition in electricity supply.

Effective competition in electricity supply will be evaluated for the following markets:

- ✓ Largest energy users: consumers connected to the 110 kV level and above (tariff category 01)
- ✓ Medium voltage energy users: consumers connected to the 35 kV and 10 kV levels (tariff category 1 and 2)
- ✓ Low voltage energy users: consumers connected to the 0.4 kV level and classified in tariff category 3
- ✓ Small low voltage energy users: tariff categories 4 to 8

The ERO bases its evaluation of the existence of effective competition on whether there is evidence that a competitive supplier was able to enter the relevant market and be successful in attracting consumers from the Public Supplier. The ERO considers that, for reasons of clarity and transparency, the evidence used in the evaluation has to be able to be defined in objective terms, clear and easily measurable. Considering this, the ERO assesses that the level of effective competition in supply be evaluated based on two main criteria:

- *The number of active independent suppliers in the relevant market (apart from the Public Supplier).* – This ensures a measure of competition intensity. For this reason, the ERO has decided that the active supplier to be considered for the evaluation of the competition criteria is one that supplied at least 10% of the respective market in the previous year, measured according to total energy consumption volumes.
- *Share of the market served by independent suppliers.* – This ensures a measure of effectiveness of competitive suppliers in attracting consumers, and as such their ability to secure some control over the market power of the Public Supplier.

In accordance with the ERO decision on competition criteria, a relevant market is considered competitive if it fulfills the following conditions:

- The number of suppliers in the relevant market, not including the public supplier, must be 3 or more; and
- The share of the relevant market served by the supplier, not including the public supplier, must exceed 30%.

Conclusions of the three year Competition review

Based on the above mentioned criteria, and by reviewing the factual situation, the ERO considers that there is still no effective competition in electricity supply in Kosovo. Currently, all the consumers that have the eligible consumer status are supplied by the only supplier with regulated tariffs. The reason for supplying eligible consumers with regulated tariffs is that in Kosovo, apart from the public supplier, no other independent suppliers are operating.

The scale of competition in Kosovo is low, where a single state generator (TTP Kosovo A, B) dominates about 90% of the internal market, which shows that there is no proper competition on the generation side.

As for supply, the Public supplier currently has the monopoly on electricity transactions with consumers, and this is an obstacle for new independent suppliers to enter the market.

With the current regulated price, the interest of eligible consumers to exercise their right is limited or non-existent. In order to create an opening of a market that functions properly, it is necessary to gradually increase the number of consumers in the open market. This can be done by either eliminating the option of regulated tariffs for eligible consumers, or by changing tariff rules.

Third party access in a transparent way enables proper competition in an energy market. KOSTT has prepared a good legal and technical framework for third party access in the Kosovo market, its relevance to the transmitting system and functions of Market Operator, so we can conclude that this can be executed successfully. Of course, this access refers to the wholesale market, whereas the execution of the retail market relates to fulfilling criteria in the distribution system, where until now there has been no methodology for using the distribution system, however the designed tariff model foresees this separation, so this should not be considered an obstacle. What can be considered an obstacle is the implementation of these tariffs, because of high level of technical and commercial losses in distribution and in deficiency of multifunctional measurements for small consumers.